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No. 73-1894

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In the Supreme Court of the United States

OCTOBER TERM, 1973

SIDNEY FLAXMAN,

Petitioner,

VS.

THE UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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Petitioner, Sidney Flaxman, prays that a writ of certiorari be issued to review the judgment of the United States Court of Appeals for the Seventh Circuit, entered in this cause on April 23, 1974.

Opinion Below

The opinion of the Court of Appeals is presently unreported. It is reprinted as Appendix A, infra.

Jurisdiction

The judgment of the Court of Appeals (Appendix B, infra) was entered on April 23, 1974. A timely Petition for Rehearing and Suggestion of Appropriateness of a Rehearing En Banc was filed, and was denied on May 21, 1974. (Appendix C, infra) The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

QUESTIONS PRESENTED FOR REVIEW

Is a scheme to defraud the State of Illinois by submission of understated sales tax returns within the ambit of the federal mail fraud statute, where the mailings were incidental and collateral to the alleged scheme to defraud; and is a scheme to defraud the State of Illinois through submission of understated sales tax returns within the ambit of the federal mail fraud statute, where the State of Illinois has enacted its own statutory penalty for such conduct, and where the evidence showed that as to the taxpayers involved, it was the practice of the State of Illinois to knowingly accept sales tax returns which understated retail sales?

STATEMENT OF THE CASE

Petitioner, Sidney Flaxman, and four former officials of the Steinberg-Baum Company were named in an eight count indictment charging conspiracy and mail fraud in violation of Sections 371 and 1341 of Title 18, U.S.C. As it related to petitioner, the indictment alleged a scheme to defraud the State of Illinois by the filing of Retailers' Occupation Tax returns which understated the revenues of 13 retail stores operated by the Steinberg-Baum Company during the period January 1, 1968, through January 30, 1971.

After a bench trial petitioner was found guilty on all eight counts of the indictment and sentenced to concurrent two year prison terms on the first four counts, and concurrent two year terms of probation of the last four counts, the probation to be served consecutive to the prison terms.

Petitioner was an independent public accountant retained by Steinberg-Baum to prepare the Retailers' Occupation Tax Returns from data supplied him by the company. Each of the 13 retail stores operated by Steinberg-Baum was itself a separate corporation and filed a separate Retailers' Occupation Tax Return with the State of Illinois. Each month an employee of Steinberg-Baum would obtain totals of the cash and charge sales of each store, and would transmit the information to another employee who would enter the figures onto a general journal. When these figures were prepared, petitioner would come to the Steinberg-Baum office and prepare the Retailers' Occupation Tax Returns from these figures. Flaxman would give the completed returns back to a Steinberg-Baum employee who made out checks for payment of the tax and then took the completed returns and the checks to one Leonard Freedman,

the general manager of Steinberg-Baum and a co-defendant, for signature. The returns and checks were then placed in pre-printed envelopes furnished by the State of Illinois and placed in a box kept in the office for outgoing mail.

The sales tax returns so filed for the 13 stores during the period January 1, 1968, through March 31, 1971, were shown to have understated the true sales of the stores by approximately $30 million.

Flaxman testified that when he first prepared sales tax returns for Steinberg-Baum, he submitted the completed returns for approval to Louis Steinberg, a co-defendant. Steinberg told him that he had a large amount of exempt wholesale sales which he could prove and which should be deducted from the total on the returns. Steinberg gave Flaxman a figure for wholesale sales, and Flaxman then prepared the returns showing the wholesale sales as a deduction from the gross sales figure. Flaxman then showed this return to Steinberg for approval, but Steinberg told him that he did not want the return to reflect the wholesale figure, and directed him to show only the net retail sales figure on the return.

Flaxman followed this procedure of reporting only the net retail sales figure on the return without disclosing that a deduction for wholesale sales was being claimed each month during the period charged in the indictment. Flaxman said that in each instance Steinberg gave him the figure for wholesale sales which he was to deduct from the gross sales figure. The net figure which he reported on the return frequently amounted to ten percent of the total actual sales of the stores.

Leonard Freedman, the former general manager of Steinberg-Baum, testified for the government that he had never seen a report of wholesale sales from the stores. He further testified that it was a "rule of thumb" within the Steinberg-Baum Company to report only ten percent of sales on the Retailers' Occupation Tax Returns. Freedman said that these returns were then negotiated with the State of Illinois, and that as a result of these ongoing negotiations the percentage of sales declared on the returns was subsequently raised to up to fifty percent of the retail sales.

REASONS FOR GRANTING THE WRIT

Petitioner Sidney Flaxman stands convicted of conspiracy and mail fraud, upon an indictment charging a scheme to defraud the State of Illinois through submission of understated retail sales tax returns. The government's unprecedented use of the mail fraud statute to reach this local tax matter, peculiarly within the province of the State of Illinois, raises fundamental questions as to the scope of federal criminal jurisdiction which merit review by this Court.

Petitioner, a certified public accountant, prepared understated Illinois Retailers' Occupation Tax Returns for various retail outlets of the Steinberg-Baum Company. Once completed, the returns were submitted to the State of Illinois by mail. A government witness, a former Steinberg-Baum officer, testified that it was company policy to report only 10% of retail sales on the returns, and to then negotiate the returns with the State of Illinois over the additional amount to be remitted by Steinberg-Baum. He said that these on-going negotiations eventually resulted in Steinberg-Baum reporting up to 50% of retail sales on the returns.

The government maintained this prosecution under the mail fraud statute, 18 U.S.C. §1341, which provides in relevant part:

> "Whoever, having devised * * * any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses * * * for the purpose of executing such scheme or artifice or attempting to do so * * * knowingly causes to be delivered by mail * * * any matter or thing * * *".

This statute has, with various modifications, been in force for more than a century. Throughout its history, it has been emphasized that the statute does not reach all frauds involving the use of the mails, but only those where the abuse of a federal instrumentality, the Post Office, is an integral part of the execution of the fraud. *Kann* v. *United States,* 323 U.S. 88, 95 (1944); *Parr* v. *United States,* 363 U.S. 370, 380 (1960); *United States* v. *Kelem,* 416 F.2d 346, 347 (9th Cir. 1969), cert. denied, 397 U.S. 952 (1969); *United States* v. *Maze,* 468 F.2d 529, 536 (6th Cir. 1972), affirmed, 94 S.Ct. 645 (1974). The statute was never intended either to infringe upon state law enforcement, or to be a part of a scheme of federal-state cooperation. See, *United States* v. *Sheridan,* 329 U.S. 379, 387 (1946).

In *Kann* v. *United States,* supra, the Supreme Court said, with regard to jurisdiction under the mail fraud statute,

> "The federal mail fraud statute does not purport to reach all frauds, but only those limited instances in which the use of the mails is a part of the execution of the fraud, leaving all other cases to be dealt with by appropriate state law." 323 U.S. at 95.

The principal that local frauds should be prosecuted by local authorities rather than under the federal mail fraud statute is similarly expressed in *United States* v. *Kelem,* 416 F.2d 346 (9th Cir. 1969) and *United States* v. *Chason,* 451 F.2d 301, 304 (2d Cir. 1971).

In *Kelem,* 416 F.2d 346 (1969) the court said:

> It is elementary that the jurisdiction of federal courts is defined and limited by the Constitution and congressional action; hence, statutes such as section 1341 should be carefully and strictly construed in order to avoid extension beyond the limits intended by

> Congress. Healy v. Ratta, 292 U.S. 263, 270, 54 S.Ct. 700, 78 L.Ed. 1248 (1933); Kline v. Burke Constr. Co., 260 U.S. 226, 233-234, 43 S.Ct. 79, 67 L.Ed. 226 (1922). Moreover, such construction is especially appropriate where, as here, the Government urges that we construe a federal criminal statute so that it reaches conduct which the states should appropriately control and which they can control, effectively. Indeed as the Supreme Court has emphasized, section 1341 is not designed to reach all frauds "but only those limited instances in which the use of the mails is a part of the execution of the fraud, leaving all other cases to be dealt with by appropriate state law."

If application of the mail fraud statute is indeed limited to those situations involving a distinctly federal interest, the statute does not reach the situation here, where the alleged criminal conduct is directed against a sovereign state, and where use of the mails is wholly tangential to execution of the scheme. The retail sales tax returns in question were prepared by Petitioner at the offices of Steinberg-Baum. The returns were executed there by an official of the company, and checks were drafted in the amount shown to be due on the returns. Only then, after the alleged scheme had reached fruition, was the mail employed to submit the returns to the State of Illinois.

The Supreme Court has recently taken the opportunity to underscore its disapproval of convictions based upon mailings which were not for the purpose of executing a scheme to defraud. In *United States* v. *Maze,* 94 S.Ct. 645 (1974), the Court affirmed the reversal of a mail fraud conviction where the defendant had utilized a stolen credit card to obtain food and lodging, and those establishments transmitted invoices by mail to the issuing bank for those services. In holding that the mailings were not "sufficient-

ly closely related" to the scheme, Mr. Justice Rehnquist noted for the majority that, "Congress could have drafted the mail fraud statute so as to require only that the mails be in fact sued as a result of the scheme. But it did not do this; instead, it required that the use of the mails be for the purpose of executing the scheme." *Id.* at 651. See also, *United States* v. *Miles*, ... U.S. ..... (March, 1974).

As in *Maze*, supra, the use of the mails here was utterly tangential to the execution of the scheme. For any purpose connected with the scheme, personal delivery to the State of Illinois would have sufficed. The mails were not used here to accomplish the scheme, nor to "lull" the State of Illinois into not suspecting that it had been defrauded, nor to conceal the fraud. The mails came into use only after the understated returns had been completed and executed, and the scheme thus already accomplished. Whether the mail fraud statute may reach such a situation is the first issue of significance raised by Petitioner's conviction.

The second issue, related yet distinct, is whether a scheme to defraud a state by filing understated state sales tax returns is within the ambit of federal criminal jurisdiction generally, and the mail fraud statute in particular. The State of Illinois, in the exercise of its sovereign powers, has enacted a system of taxation upon retail sales of tangible personal property. See, Chapter 120, Illinois Revised Statutes, Chapter 440, et. seq. Illinois has also provided for a system of collecting that tax, and of punishing those who file understated retail sales tax returns. Chapter 120, Illinois Revised Statutes, Section 452, as in effect during the period charged in the indictment, provided in relevant part:

> "Any person engaged in the business of selling tangible personal property at retail in this state * * * who files a fraudulent return * * * is guilty of a misdemeanor, and upon conviction thereof, shall be fined not less than $25.00, nor more than $5000, or be imprisoned in a penal institution other than a penitentiary for not less than 1 month, nor more than six months, or be both so fined and imprisoned * * *."

The record makes clear that, in the further exercise of its sovereign powers, the State of Illinois was willing to accept from Steinberg-Baum sales tax returns which reflected less than 100% of actual retail sales. A former Steinberg-Baum official, testifying as a government witness, stated that it was a "rule of thumb" within the company to file returns reflecting only 10% of actual retail sales, and to then negotiate additional amounts due with the State of Illinois.

He further testified that as a result of these on-going negotiations, the percentage of retail sales reported on the returns by Steinberg-Baum eventually rose to 50%.

If the State of Illinois was willing to accept either the 10% or 50% figure on the returns, it did not consider itself to have been defrauded. In very real effect, the Federal government has prosecuted petitioner because it disagrees with the manner in which the State of Illinois administers its own revenue laws. If the State of Illinois considered the filing of an understated sales tax return to be only a misdemeanor, and then, in the further exercise of its sovereign powers over the administration of its own tax laws, determined that it would accept understated returns, certainly the state was acting within its own prerogatives.

Admittedly, the literal language of the mail fraud statute would encompass this situation. That does not end the inquiry, however. In *Sorrells* v. *United States,* 287 U.S. 435 (1932), the Supreme Court held that, although a defendant had engaged in conduct proscribed by a federal statute, it would refuse to apply a statute where the result would be unreasonable or unjust. Quoting from *United States* v. *Kirby,* 7 Wall, 482, 19 L.Ed. 278, the Court said,

> "All laws should receive a sensible construction. General terms should be so limited in their application as not to lead to injustice, oppression, or an absurd consequence. It will always, therefore, be presumed that the legislature intended exceptions to its language, which would avoid results of this character. The reason of the law in such cases should prevail over its letter."

These principles take on special importance where, as here, we deal with the delicate balance between federal and state jurisdiction. See, *Palmer* v. *Massachusetts,* 308 U.S. 79, 83-4 (1935). Recently, this Court twice struck down literal interpretations of federal criminal statutes on grounds that literal interpretations would encroach upon the prerogatives of the states. In *Rewis* v. *United States,* 401 U.S. 808 (1971), the Court considered the limits of the "Travel Act", 18 U.S.C. §1952, which forbids the use of facilities of interstate commerce in aid of an unlawful activity. In reversing the convictions of two operators of a Florida lottery located just across the Georgia border, the Court said,

> "Given the ease with which citizens of our Nation are able to travel and the existence of many multistate metropolitan areas, substantial amounts of criminal activity, traditionally subject to state regulation, are patronized by out-of-state customers. In such a context, Congress would certainly recognize that an expansive Travel Act would alter sensitive federal-state relationships, could overextend limited federal police

> resources, and might well produce situations in which the geographic origin of customers, a manner of happenstance, would transform relatively minor state offenses into federal felonies."

In *United States* v. *Bass*, 404 U.S. 336 (1971), the Supreme Court affirmed the reversal of a conviction under Section 1202(a)(1) of the Omnibus Crime Control and Safe Streets Act, 18 U.S.C. §1202(a). The Court read that section to require a nexus between possession of a weapon and interstate commerce, and rejected the government's contention that the statute did not require such a showing. The Court said,

> "Because its sanctions are criminal and because, under the Government's broader reading, the statute would mark a major inroad into a domain traditionally left to the States, we refuse to adopt the broad reading in the absence of a clearer direction from Congress." *Id.* at 339.

The Court then relied in part on its earlier decision in *Rewis* v. *United States*, supra, and emphasized that it would not lightly assume that Congress intended a statute to alter delicate federal-state relationships.

The rationale of this Court in *Rewis* and *Bass* applies with even greater force to the case at bar. Here the federal government, through the mail fraud statute, is attempting to administer the revenue collection procedures of the State of Illinois. The record establishes that the State of Illinois knowingly accepted understated sales tax returns from Steinberg-Baum. Yet the federal government is in effect telling the State of Illinois that it can no longer follow such a procedure. Collection of its own revenues is a matter wholly within the sovereign province of the State of Illinois. Use of the mail fraud statute here is unwarranted, and clearly does great violence to established federal-state relationships.

One additional aspect of the government's use of the mail fraud statute to reach local revenue collection procedures requires mention. The Chief Justice of the United States had repeatedly warned that the continued expansion of federal jurisdiction poses a very real danger to an already overburdened federal judiciary. See Burger, The Courts on Trial, 22 F.R.D. 71; Burger, The State of the Judiciary—1970, 56 A.B.A. Journal, 929 (October, 1970). The case at bar may well be only the harbinger of a myriad of federal attempts to police local revenue collection through the mail fraud statute. Already, in a case presently pending on appeal, the government utilized the mail fraud statute to reach a scheme to defraud the State of Missouri through the filing of understated sales tax returns. *United States* v. *Mirabile* (8th Cir., No. 1367). So drastic an expansion of federal criminal jurisdiction into areas traditionally, and best, left to the states, ought not be permitted without review by this Court.

Conclusion

For the above and foregoing reasons, we respectfully submit that a writ of certiorari should be issued to review the judgment of the United States Court of Appeals for the Seventh Circuit entered in this case.

Respectfully submitted,

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